

Multistate Tax Commission



**Multistate Tax Commission
Uniformity Committee
Court Yard Hotel by Marriott
170 Fourth Avenue North
Nashville, Tennessee 37219
March 14 and March 15, 2006
Minutes of Meeting**

I. Welcome and Call to Order

The Chair called the meeting to order. The following individuals attended one or more of the meetings of the Sales/Use Tax Subcommittee, the Income/Franchise Subcommittee, or the Full Uniformity Committee:

	State or		State or
Name	Affiliation	Name	Affiliation
Ted Spangler Chair Uniformity Committee	ID	Adina Christian Chair, Sales/Use Tax Subcommittee	TX
Holly Hinson	AL	Frank Hales	UT
Robert Lambert	CA	Jan Bianchi	WA
Carl Joseph	CA FTB	Private Sector	
Phillip Horwitz	CO	Jeff Friedman	Asbill & Sutherland
Joe Thomas	CT	Deborah Bierbaum	AT & T
Marshall Stranburg	FL	Diann Smith	COST
Barbara Nichols	ID	Doug Anderson	Expedia
Kurt Van Brocklin	LA	Lori Powers	Hilton Hotels
Leonore Heavey		Mike Fannon	
Glenn White	MI	Cindy Ohlenforst	Hughes & Luce
Keith Getschel	MN	Beth Anne Stanford	InterContinental Hotels
Larry Wilkie		Ken Helms	
Wood Miller, Chair Income/Franchise Tax Subcommittee	MO	John Allan Carl Erdman Stephanie Anne Lipinski Galland	Jones Day Skadden Arps Thompson Coburn TWC
Brenda Gilmer Eugene Walborn Lee Baerlocher	MT	Jamie Fenwick	

	State or		State or
Name	Affiliation	Name	Affiliation
Lennie Collins	NC	MTC Staff and Consultants	
Mary Loftsgard	ND	Joe Huddleston	
Lee Evans	NJ	Gregory Matson	
Diana Vasquez	NM	Frank Katz	
Heidi Chowning		Ken Beier	
Doug Adair	OR	Roxanne Bland	
Eric Smith		Elliott Dubin	
Janielle Lipscomb	OR	Sheldon Laskin	
John Rogers	SC	Thomas Shimkin	
Loren Chumley	TN (AG's Office)	Jeff Silver	
Sherry Harrell		Shirley Sicilian	
Barbara Sampson		Walt Nagel	Consultant, via telephone
Wyla Posey			

II Approval of Minutes of November 2005 Meeting

California moved that the minutes of the November 2005 meeting be accepted. Oregon seconded the motion. The minutes were approved unanimously.

III Public Comment Period

Diann Smith of COST asked if written comments could be introduced at some later date.

IV Report of the Executive Director

- *Systems and Technology Issues*

The Executive Director informed the Committee that there is now a contract with EMagination of Baltimore, MD to redesign the MTC website and to provide a secure communication platform for the MTC and for the member states. The system would be as good as the IRS system and the systems of most states. The Committee members will be contacted about developments to the website and of the communication system.

- *Information sharing with the Internal Revenue Service*

The MTC is a signatory to all information agreements with the states. The MTC is discussing with the IRS the possibility of receiving federal tax information, under the federal provision which would allow such information to be disclosed to a contractor for the states.

- *Federal Legislation*

The Executive Director informed the members of the Committee that the staff continues to monitor federal legislative developments including the Streamlined Sales Tax legislation;

business activity tax legislation; H.R. 1369, a 4R Act equivalent for natural gas pipelines; and telecommunications legislation. The Executive Director noted that H.R. 4845, a 97 page bill was introduced by Representative Goodlatte of VA, contains a business activity nexus section which is quite similar to his other bills except that in H.R. 4845 defines all computer software as either a service or an intangible product.

- *State membership*

The Executive Director told the Committee that he will work to increase the participation of all states with MTC projects.

- *Personnel Matters*

The Executive Director congratulated Selvi Stanislaus on her appointment as Executive Officer of the CA Franchise Tax Board; and told the members that the goal was to have a Deputy Director on board as of May 1st. {Editors note: the new Deputy Director is Gregory Matson, formerly of the Tax Executives Institute.}

Income and Franchise Tax Segment

Roundtable Discussion

MO reported that the legislature is discussing the possibility of reviewing MO statutes and regulations and comparing them to MTC uniformity recommendations. **ID** reported that the legislature did not pass a bill on withholding from pass-through entities. **MT** reported they are investigating RIC's and REITs. There were court cases involving business/non-business income allocations. **UT** reported that their reportable transactions law will take effect in 2007. **NC** reported that they adopted addback statutes for royalty payments for trademarks only. They are also studying REITs. **OR** reported that they are shifting to a single sales factor apportionment formula; they also changed their definition of financial institutions; and refunds to corporations will be around \$200 million. **MN** reported that their VCI program ended in January. They adopted non-resident withholding of pass-through income but not on publicly traded partnerships. **FL** reported they are possibly changing their definition of non-business income. They are studying REIT issues. **NM** reported that their Supreme Court upheld the lower court decision on the KPI issue; the unitary business definition did not pass. **MI** reported that there is a bill pending to repeal the Single Business Tax. **TN** reported that they are considering nexus and apportionment issues and a disclosure rule for deductions. **AL** reported that they changing the sourcing rule for sale of intangibles from cost-of-performance to destination. **CO** reported that their cost-of-performance rule for sourcing of bank loans is in settlement conference. **CA** reported that their Supreme Court ruled that the LLC fee is unconstitutional because it is a tax. There is a bill to shift to a single sales factor apportionment formula. **LA** also reported that there is a bill for single sales factor apportionment for manufacturing only.

V. Reports and Updates

A. Reports on Uniformity Projects Pending Before Executive Committee or Full Commission

1. Model Combined Reporting Statute

Ms. Sicilian informed the Subcommittee that this project was approved for a public hearing in 2005; there were two hearings. The Executive Committee approved the amendments proposed in the Hearing Officer's Report. The recommendation passed a bylaw 7 survey, but, there was no quorum in Boise to vote on adoption. The recommendation will be voted on in Topeka in August of 2006.

2. Reportable Transactions and companion Voluntary Compliance Statutes

A public hearing was held in September of last year. There were written requests for extensions of the public comment period to allow for additional public comments. Therefore two hearing officer reports were filed, a preliminary report in November and a final report in April after the receipt of additional public comment.

Diann Smith, COST, asked why the economic substance doctrine is included in the statute and the definition of tax shelter deleted. Ms. Sicilian noted that the federal version made no reference about non-economic substance in statutes, however proposals have been made at the federal level to include such a reference and the courts have developed an economic substance doctrine. Therefore this recommendation includes a reference to the economic substance doctrine. Ms. Smith commented that states can use the 51 state spreadsheet as a "revenue raiser." Ms. Sicilian replied that state auditors know that state laws differ and they would be cognizant of what constitutes compliance with state laws and what constitutes a possible inconsistent filing position.

Jeff Friedman inquired about state experiences with such a spreadsheet. ND replied that businesses are generally not willing to provide that information; MT and CA agreed.

Ms. Sicilian also reported on some changes recommended in the Hearing Officer's Report on the Voluntary Compliance Initiative.

3. Model Sales Factor Regulations: Subcontractor Services Performed "On Behalf Of Other Taxpayer"

Ms. Sicilian informed the Subcommittee that the Executive Committee had tabled this model regulation for further study. The Executive Committee had made comments that they wished to have incorporated into the model regulation. Staff is working with the original drafting group to make those changes.

B. Federal Issues Affecting State Taxation

Bills Pending:

1. H.R. 1956: Business Activity Tax Simplification Act of 2005

Roxanne Bland informed the Committee that H.R. 1956 is still in the Subcommittee on Administrative and Commercial Law of the House Judiciary Committee; and it is incorporated into a new bill H.R. 4845. The major difference is that in H.R.4845, the definition of tangible personal property excludes *all* computer software. {*Ed. Note: H.R. 1956 was debated on the floor of the House and a vote is scheduled after the Labor Day recess.*}

2. H.R. 4019 State Taxation of Non-Resident Pensions

Ms. Bland explained that this bill deals only with the pensions of former partners of professional partnerships. [Ed. Note: the bill was presented to the President on July 27, 2006]

V. Telecommunications Apportionment Regulation**A. Project Summary**

Ms. Sicilian reviewed the history of this project for the members of the Committee. She related that the Committee determined it would use the same definitions and sourcing provisions for telecommunications and ancillary services as does the Streamlined Sales and Use Tax Act (SSUTA).

B. Presentation by Loren Chumley and Sherry Harrell of the TN Department of Revenue

Ms. Chumley outlined the history of telecommunications taxes in Tennessee to the members of the Committee. She informed the Committee that the Telecommunications Tax Reform Initiative (TTRI) provided input to sourcing rules which were then adopted by the SSUTA in April of 2005.

Ms. Chumley said that the general SSUTA sourcing rules includes taxation of services not included in the definition of telecommunications services and that there are 4 hierarchal levels of sourcing. In 2005, the definitions of prepaid wireless services were changed. She informed the Committee that the decisions of the SSUTA Governing Board are binding on states that are in compliance.

Ms. Harrell stated that where services have been excluded from the definition for sales/use tax purposes, they may be included in definitions for income tax purposes. Under sales/use taxation, states have the flexibility to tax or exempt certain services. Ms. Sicilian noted that under income taxation business to business sales must be taken into account; e.g., backbone services and leases of bandwidth.

VI. Model Add-back Statute

Frank Katz, MTC General Counsel, noted that the original version of this model statute had constitutional problems because of possible multiple taxation. An exemption mechanism was added so that the income stream would be taxed only once.

In the Income and Franchise Tax Subcommittee, CO moved that the model regulation be accepted with the changes recommended by the Hearing Officer. LA seconded the motion. The motion to send this to the full Committee was passed with 16 yes votes; 0 no notes; and 2 abstentions.

In the full Committee, MO moved to send the model statute, with the Hearing Officer's recommended changes to the Executive Committee. TX seconded the motion. The motion carried with 16 yes votes; 0 no votes; and 1 abstention.

VII. Possible New Projects

A. Revision of Sections 16 and 17 of UDITPA – Sales Sourcing Rules

These sections of UDITPA deal with the sourcing of sales of services and intangibles. The Income and Franchise Tax Subcommittee decided to request a white paper. Carl Joseph, CA-FTB, volunteered to provide a white paper.

B. Sourcing Deferred Gains from Sales of Real Property – 26 U.S.C. § 1031

The question facing the Subcommittee is: when the gain is realized for federal tax purposes, what portion of the gain should be assigned to state in which the property was exchanged? Another possible question is: Should there be a uniform multistate reporting system? Montana stated they would bring additional information to the Committee at the August meeting.

C. RIC's and REIT's

There was a general consensus among the members of the Income and Franchise Tax Subcommittee, and in the full Committee that these are big issues, especially in separate entity states. Several court cases were cited. In the Income and Franchise Tax Subcommittee, CO moved that the Committee take up the subject of RIC's and REIT's. OR seconded the motion. The motion carried – 16 yes votes; 0 no votes; and 0 abstentions. The full Committee voted, by voice, to take up the issue of RIC's and REIT's.

Sales Tax Segment

Roundtable Discussion

ID reported that there is legislation to allow the state to participate in the SSTP. LA reported that it won a DELL case – the use of independent contractors created nexus for DELL. SC reported that it will use sales tax revenues for property tax relief. CO reported that there will be a sales tax refund to all sales tax payers. AL reported that it will require firms with state contracts to register for sales tax. They are study methods to value oil and gas products at the wellhead. NJ reported that a rate increase is possible *{Ed note; there was a rate increase.}* CT reported that it is getting 3rd party information on liquor distributors. MN reported that it will impose the sales tax on cosmetic surgery. ND reported that there is a pending court case involving school funding. They

will probably use sales tax revenues for the increased state share of school funding. WA reported that SSUTA legislation failed in the legislature. They passed an exemption for the forest products industries. NM reported that their Supreme Court reversed a lower court ruling on the KPI case. They eliminated some intangibles from the definition of products. FL reported that they are engaged with an auto manufacturer regarding taxes on goodwill warranties. They are now taxing parts on off-warranty repairs. Other items include: bad debt issues on involving credit card sales, and possible expansion of sales tax holidays. MI reported they are working on SSUTA definitions of telecommunications services and an issue of uses tax on used cars. UT reported that they reduce the sales tax on food and are now out of compliance with SSUTA. TX reported problems with destination based sourcing of intrastate sales. CA reported that Barnes & Noble in-state stores create nexus for the on-line affiliate.

VIII. Report on Uniformity Projects Pending Before Full Commission

A. Model Affiliate Nexus Statute

Frank Katz informed the Committee that this model statute had passed the Bylaw 7 survey requirements and would be presented at the full Commission at the Annual Meeting in August in Topeka, KS.

IX. Hotel Intermediaries Project

A. Presentation by Expedia

Doug Anderson of Expedia presented the business model models used by the industry and the relevant tax bases. His presentation focused on who is responsible for remitting the tax and what is the consumers' use tax obligation. Under all models, the hotels negotiate with third party intermediaries (TPI's). Under one model, the hotel and the TPI negotiate a facilitator's fee the markup between the price quoted to the customer and price received by the hotel is fixed. Under another model, the room rate is fixed and the TPI is free to get whatever price can be earned in the market. Under a third model, the hotel fee is often bundled with other travel costs.

- MODEL 1: the hotel pays the tax on discounted rate.
- MODEL 2: the hotel pays the tax on the fixed room rate.
- MODEL 3: this is the most difficult model to determine the tax

The major concerns of hotel operators are: 1) that the tax liability should be based on the amount they actually receive for the room and not the price paid by the consumer; and 2) there should be no outstanding use tax liability for the guests. This is most difficult with a bundled transaction since the consumer may not know the cost of each separate component of the trip.

B. Financial Accounting Presentation

John Allan of Jones, Day presented a possible method for apportioning the tax:

- The TPI, if not an agent of the hotel, would be taxed on a facilitator's fee which would be sourced to the state of residence of the consumer
- The facilitator's fee would not be subject to the hotel, transient, and occupancy tax

The industry will send PowerPoint of alternative models to Roxanne Bland. There will be teleconference calls in April to agree on the definition of common terms. The industry will provide a model statute by May 15th.

X. Statistical Sampling

Policy Checklist:

- States should retain the right to use statistical sampling
- Statistical sampling should be used when records are adequate and so voluminous that any other method is impractical

Due to a lack of time, the discussion was curtailed. The members of the Committee will spend the rest of the month examining the policy checklist and send their comments to Roxanne Bland by March 31st. Ms. Bland will determine which states do not have any enabling legislation.

XI. Federal Issues Affecting State Taxation

A. GAO report on Internet Access Tax Freedom Moratorium

GAO estimated the revenue impact of the moratorium on state and local governments at \$200 million in 2007. This estimate was derived by adding the Congressional Budget Office (CBO) estimate of \$120 million and the estimated \$80 million that state and local governments are currently collecting on Digital Subscriber Line (DSL) services. The CBO/GAO estimates are based on interviews with state revenue agency personnel regarding the amount of revenue derived from Internet access taxes on retail customers – households, businesses, and if applicable, governments. No estimates of the revenue impact are provided for states that impose telecommunications taxes on the charges to Internet Service Providers (ISP) for their connection to the Internet. For example, if the retail subscriber uses a “dial up” connection to access the Internet, there are charges to the ISP for connecting to the telephone company switch, another charge for an interoffice link, and another charge for the ISP link to its Point of Presence (POP) on the Internet. Some state and local governments impose taxes on the charges for those links. Some state and local governments impose similar taxes on the linkages for subscribers using wireline broadband services (cable, DSL, TI, and fiber optic), and wireless broadband service. GAO and CBO interpreted the Internet tax moratoria to permit state and local governments to continue to impose telecommunications taxes on these “backbone” charges.

MTC staff believes the revenue estimates contained in the GAO report understate the revenue impact of PL 108-435. The difference in MTC staff revenue estimates and the GAO estimate is due to differences in the interpretation of Internet access. P.L. 108-435 states that “Internet access does not include telecommunications services, except to the extent such services are purchased, used, or sold by a provider of Internet access to provide Internet access.” GAO

interprets Section 2(2) to mean that state and local governments can impose their telecommunications and/or sales/use taxes on the “backbone” telecommunications charges. Conversely, MTC staff and not unexpectedly, a number of telecommunications service providers and ISP¹ interpret the language in that section of the bill to mean that state and local governments are precluded from imposing taxes on “backbone” charges. Indeed, GAO acknowledges that some state revenue agencies have construed the language of the bill to mean that wholesale costs and backbone charges are subject to the moratorium.

B. Streamlined Sales Use Tax Act

Len Lucchi reported that there are two bills in the Senate Finance Committee (S. 2152 and S. 2153), but he doesn’t think there will be any action on either bill soon; there is corresponding legislation in the House.

C. Telecommunication Tax Act Renewal

Mr. Lucchi reported that the state tax savings clause will remain in the new bill.

XII. New Business

Diann Smith of COST suggested a topic that MTC, FTA, NGA, NCSL, and COST could work on together – uniformity of withholding of income taxes on employees traveling to work in various states. COST is looking at possible federal legislation to provide such uniformity.

The members voted on the location of the Spring meeting: San Diego 13; Tampa/St. Petersburg 11; New Orleans 5; and El Paso 2.

XIII. Adjournment

The meeting was adjourned at 3:15 P.M.

¹ U.S. GAO, *op. cit.*, pp. 36 – 44.